

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B03

PLR-108485-07

Date:

February 12, 2008

Legend:

X =

Y =

Trust =

A =

B =

C =

D =

d1 =

d2 =

d3 =

d4 =

d5 =

Dear :

This letter responds to a letter dated February 13, 2007, and subsequent correspondence, written on behalf of X, requesting rulings under § 1362(f) of the Internal Revenue Code.

Facts

According to the information submitted, X was incorporated on d1 and elected under § 1362(a) to be an S corporation effective d2. At the time the election was filed, one of X's shareholders, Trust, a testamentary trust, was not an eligible S corporation shareholder under § 1361(c)(2). During the time Trust held shares of X stock, all of X's items of income, loss, deduction, and credit allocated to Trust were reported by individuals A and B, the beneficiaries of Trust. By d3, all of the shares of X stock held by Trust had been transferred to A and B.

On d4, X issued stock to Y, an S corporation. The shareholders of Y were individuals C and D. As an S corporation, Y was an ineligible S corporation shareholder under § 1361(b)(1)(B). On d5, Y transferred the shares of X stock to C and D in accordance with their ownership percentages in Y.

X and its shareholders represent that X's ineffective S corporation election and subsequent termination were inadvertent, unintended, and were not motivated by tax avoidance or retroactive tax planning. From d2 onward, X and its shareholders have consistently treated X as an S corporation. In addition, X and its shareholders agree to make any adjustments consistent with the treatment of X as an S corporation that the Secretary may require.

Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1362(a)(1) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

For S corporation elections made and terminations occurring before January 1, 2005, § 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion

Based solely on the facts submitted and representations made, we conclude that X's S corporation election was ineffective for the taxable year beginning d2 because Trust was an ineligible shareholder of X. We conclude that the ineffectiveness of X's S corporation election was inadvertent within the meaning of § 1362(f).

We also conclude that X's S corporation election terminated on d4 when shares of X stock were transferred to Y, an ineligible shareholder of X. We conclude that the termination was inadvertent within the meaning of § 1362(f).

Under the provisions of § 1362(f), X will be treated as an S corporation from d2 and thereafter, provided that, apart from the inadvertent termination ruling above, X's S corporation election was otherwise valid and is not otherwise terminated under § 1362(d). In addition, during the period that Y held shares of X stock, C and D will be treated as owning the shares of X stock held by Y in accordance with their ownership percentages in Y.

Accordingly, from d2 and thereafter, the shareholders of X must include their pro rata share of the separately and nonseparately computed items of X as provided in § 1366, make any adjustments to stock basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368.

Except as specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, we express or imply no opinion regarding whether X is otherwise eligible to be an S corporation.

This ruling is directed only to the taxpayer requesting it. Pursuant to § 6110(k)(3) of the Code, this ruling may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

/s/

Mary Beth Collins
Senior Technician Reviewer, Branch 3
(Passthroughs & Special Industries)

Enclosures (2)

A copy of this letter

A copy for § 6110 purposes

cc: